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No. 88-27

Supreme Court, U.S.

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In the Supreme Court of the United States

OCTOBER TERM, 1988

RUSCO INDUSTRIES, INC., PETITIONER

v.

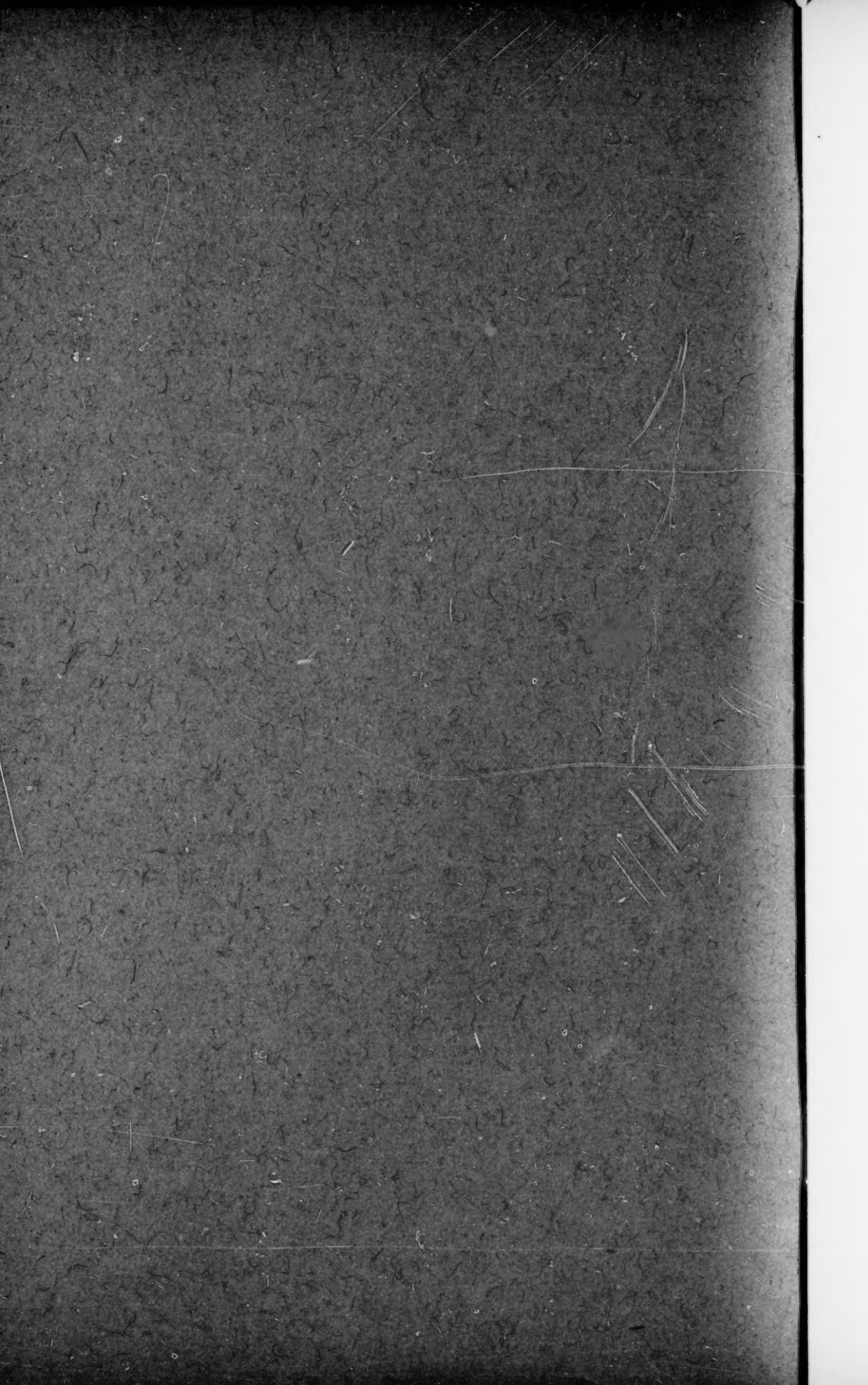
ANN McLAUGHLIN, SECRETARY OF LABOR

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether, where an employer has produced goods in violation of the Fair Labor Standards Act and subsequently declared bankruptcy, a district court acting at the behest of the Secretary of Labor retains power under 29 U.S.C. 217 not only to enjoin the sale of such "tainted" goods, but to allow their sale on the condition that the taint be removed by turning over to the Secretary the fruits of the sale equal to the unpaid minimum wages.



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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 10a-17a) is reported at 842 F.2d 270. The March 20, 1986 opinion of the district court granting a temporary restraining order is reported at 27 Wage & Hour Cas. (BNA) 1476 (App., *infra*, 1a-4a). The following orders are unreported: the March 24, 1986 order of the district court authorizing the sale of Rusco's inventory and ordering the deposit of the proceeds in the district court registry (App., *infra*, 5a-6a); the May 27, 1986 order of the district court transferring the matter to the bankruptcy court (Pet. App. 1a-2a); the November 6, 1986 order of the bankruptcy court denying the Secretary of Labor's motion for disbursement of funds (*id.* at 3a-7a); and the November 13, 1986 order of the district court adopting the opinion of the bankruptcy court (*id.* at 8a-9a).

JURISDICTION

The judgment of the court of appeals was entered on April 11, 1988. The petition for a writ of certiorari was filed on July 6, 1988. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner, a manufacturer of windows and doors, did not pay its employees from January 20, 1986, to February 3, 1986, because of financial difficulty (Pet. App. 11a). On the latter date, petitioner filed for reorganization under Chapter 11 of the Bankruptcy Code, 11 U.S.C. (& Supp. IV) 1101 *et seq.* Thereafter, the Secretary of Labor brought this action in federal district court under Section 17 of the Fair Labor Standards Act (FLSA), 29 U.S.C. 217, requesting a temporary restraining order and preliminary injunction to enforce the "hot goods" provision (29 U.S.C. 215 (a)(1)),¹ which proscribes the transportation and sale in interstate commerce of goods manufactured in violation of the Act's minimum wage requirements (29 U.S.C. 206(a)).² The court granted the injunction on March 20, 1986 (App., *infra*, 1a-4a), and subsequently modified the order to allow the sale of a por-

¹ Section 15(a)(1), the "hot goods" provision of the FLSA (29 U.S.C. 215(a)(1)), states in relevant part that "it shall be unlawful for any person * * * to transport, offer for transportation, ship, deliver, or sell in commerce, or to ship, deliver, or sell with knowledge that shipment or delivery or sale thereof in commerce is intended, any goods in the production of which any employee was employed in violation of section 206 or section 207 of this title * * *." Section 17 of the FLSA gives federal district courts jurisdiction to enjoin violations of Section 15 of the Act.

² Section 6(a) of the FLSA, 29 U.S.C. 206(a), sets a minimum wage rate, currently \$3.35 per hour, for employees engaged in commerce or in the production of goods for commerce or in an enterprise engaged in these activities.

tion of the "hot goods" and to require deposit of the sale proceeds with the court (*id.* at 5a-6a). In May 1986, the district court transferred the case to the bankruptcy court (Pet. App. 1a-2a, 11a).

The Secretary of Labor filed a motion in the bankruptcy court requesting that amounts equal to unpaid minimum wages be disbursed to him from the proceeds of the sale of the "hot goods," thus removing the "taint" (Pet. App. 11a & n.3).³ In denying the motion (*id.* at 3a-7a), the court found that any disbursement required to remedy the minimum wage violation would have the practical effect of preferring one group of creditors over others, since the Secretary stated that the money would be used to pay the workers' unpaid minimum wages (*id.* at 5a-6a). It also found that such disbursement would cause assets of the estate to be released from the exclusive control of the bankruptcy court in violation of the clear purposes of the Bankruptcy Code (*id.* at 6a). The bankruptcy court ordered all proceeds turned over to the trustee and recommended that the district court dissolve its injunction (*id.* at 7a). The district court thereafter adopted the bankruptcy court opinion as its own, dissolved its injunction, and dismissed the Secretary's suit in its entirety (*id.* at 8a-9a).

2. The court of appeals reversed. Citing this Court's decision in *Citicorp Industrial Credit, Inc. v. Brock*, No. 86-88 (June 22, 1987), the appeals court noted that Congress' goal in enacting the "hot goods" provision of the FLSA was both to improve labor conditions and "to eliminate the competitive advantage enjoyed by goods produced under substandard conditions" (Pet. App. 13a (quoting *Citicorp*, slip op. 8)). The appeals court

³ The bankruptcy court had previously allowed the trustee appointed to administer petitioner's estate to sell additional inventory (Pet. App. 4a n.1) and ordered the proceeds deposited with the registry of the district court.

reiterated this Court's conclusion in *Citicorp* that preventing shipment " 'of goods produced under substandard conditions is not simply a means to enforce other statutory goals; it is itself a central purpose of the FLSA' " (Pet. App. 13a (quoting *Citicorp*, slip op. 9 n.8)). The court characterized the Secretary's suit as an injunctive action under 29 U.S.C. 217 — "not an action for damages" (Pet. App. 15a). It concluded that the action had been brought pursuant to the Secretary's police power "to protect legitimate businesses from unfair competition and to enforce the federal law regarding minimum wage" (*ibid.*). It therefore held that the suit was exempt from the automatic stay of the Bankruptcy Code (11 U.S.C. (& Supp. IV) 362(a)),⁴ and that the police or regulatory power exemption from the automatic stay (11 U.S.C. 362(b)(4) and (5)) not only "permit[s] the Secretary's action to proceed, but it also permits the Secretary to enforce the action" (Pet. App. 15a).⁵

⁴ 11 U.S.C. (& Supp. IV) 362(a) provides, in relevant part, that, except as provided in Section 362(b), the filing of a bankruptcy petition operates as a stay of

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title[.]

⁵ 11 U.S.C. 362(b) provides, in relevant part, that the filing of a bankruptcy petition does not operate as a stay

(4) under subsection (a)(1) of this section, of the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;

(5) under subsection (a)(2) of this section, of the enforcement of a judgment, other than a money judgment, obtained in an

The court further concluded that "Congress established the payment of a minimum wage as a condition precedent to the shipment of manufactured goods" (Pet. App. 15a-16a), and adverted to the discussion in *Citicorp* analogizing the "hot goods" provision to provisions banning products from interstate commerce "that are 'not produced in conformance with specified standards' " (Pet. App. 16a, citing *Citicorp*, slip op. 11). The appeals court reasoned that just as bankruptcy does not override the requirements for the inspection or proper handling of hazardous or potentially dangerous substances that are preconditions to shipping those goods in interstate commerce, bankruptcy does not override the FLSA requirement that the taint be removed from substandard goods as a condition of their sale in interstate commerce (Pet. App. 16a-17a).

ARGUMENT

The court of appeals' decision is correct and does not conflict with any decision of this Court or of any other court of appeals. Accordingly, certiorari should be denied.

1. The filing of a bankruptcy petition automatically stays most non-bankruptcy lawsuits. However, the Bankruptcy Code, as an exception, allows "the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power" (11 U.S.C. 362(b)(4)), and also allows for "the enforcement of a judgment, other than a money judgment," obtained in such an action (11 U.S.C. 362(b)(5)). In view of this Court's decision in *Citicorp*, the court of appeals correctly concluded that the Secretary's action to enjoin the interstate shipment of hot goods, and then to remove the taint from the goods that were sold by

action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power[.]

having proceeds equal to the unpaid minimum wages paid over to her for payment to the unpaid employees, is an exercise of the government's police power, and that this action is therefore exempted from the automatic stay provision of the Bankruptcy Act.

In *Citicorp*, this Court held that the FLSA's "hot goods" prohibition applies to a secured creditor seeking to sell or otherwise introduce into interstate commerce certain goods on which it had foreclosed, where those goods were produced by employees not paid in conformity with the FLSA's wage requirements. The Court explained that the aim of the FLSA was not just to establish decent wages and hours for workers, but also to "eliminate the competitive advantage enjoyed by goods produced under substandard conditions." *Citicorp*, slip op. 8. Applying the hot goods provision to secured creditors "furtheres this goal by excluding tainted goods from interstate commerce" (*id.* at 9). Moreover, this exclusion "is not simply a means to enforce other statutory goals; it is itself a central purpose of the FLSA" (*id.* at 9 n.8).

The exclusion from commerce of hot goods by the Secretary's injunctive action in this case is thus plainly an exercise of the government's "police or regulatory power" within the meaning of Section 362(b)(4) and (5). The Secretary's suit is not converted into an action covered by the automatic stay by virtue of the fact that the Secretary now asks that sufficient proceeds of the concluded sales of goods be surrendered in order to dissipate the taint. The action remains one "where a governmental unit is suing a debtor to prevent or stop a violation of * * * police or regulatory laws." S. Rep. 95-989, 95th Cong., 2d Sess. 52 (1978). In view of the strong public policy behind the minimum wage law, the action remains one primarily "not to collect a debt but rather to redress a wrong being done to the public good." *Donovan v. University of Texas*, 643

F.2d 1201, 1208 (5th Cir. 1981) (citation omitted). Accord, *Hodgson v. Wheaton Glass Co.*, 446 F.2d 527, 535 (3d Cir. 1971); *Wirtz v. Malthor, Inc.*, 391 F.2d 1, 3 (9th Cir. 1968). Cf. *General Telephone Co. v. EEOC*, 446 U.S. 318, 326 (1980) (“[w]hen the EEOC acts, albeit at the behest of and for the benefit of specific individuals [under Title VII of the Civil Rights Act of 1964], it acts also to vindicate the public interest in preventing employment discrimination”).

More specifically, the court of appeals’ order that the Secretary receive enough of the proceeds of the sale to remove the taint from the goods is not properly characterized as the enforcement of a money judgment, as is explicitly excepted from the automatic stay exemption of Section 362(b)(5) (see Pet. 10). Most obviously, there was no pending money judgment to be enforced. There was rather only a body of assets generated when the courts below allowed the sale of goods produced in violation of the minimum wage law. At the request of the Secretary, the court of appeals exercised its equitable powers to dispose of those assets in a manner so as to dissipate the taint on the illegally produced goods. Nor was the Secretary’s suit here of “the type * * * traditionally associated with the conventional money judgment.” *Penn Terra, Ltd. v. Department of Environmental Resources*, 733 F.2d 267, 278 (3d Cir. 1984). The suit did not involve an “attempt[] to seize property of the defendant” (*id.* at 275), but rather focused entirely on assets which indisputably could have been frozen indefinitely as hot goods barred from commerce by 29 U.S.C. 215.⁶

⁶ In any event, the fact that a debtor’s compliance with the FLSA might require the expenditure of money does not bring the Secretary’s action to enforce such compliance within the terms of the “enforcement of * * * a money judgment” exception to the Section 362(b)(5) exemption from stay. See *Penn Terra, Ltd. v. Department of Environmental Resources*, *supra* (injunction requiring the expenditure

2. The court of appeals' holding that a debtor in bankruptcy must comply with the FLSA's "hot goods" provision is supported by this Court's decision in *Citicorp*. The Court stated that "Congress has determined that [hot goods] are contraband." *Citicorp*, slip op. 12. Just as "secured creditors take their security interests subject to the laws of the land" (*id.* at 11), debtors in bankruptcy also are not free to deal in "contraband" items in violation of the law.⁷

Thus, petitioner errs in arguing (Pet. 9) that the Secretary should not be allowed to enforce the "hot goods" provision here because "requiring the bankruptcy trustee to pay the Secretary" has the "undeniable effect" of prefer-

of money by a bankruptcy debtor to comply with environmental laws is not an action to "enforce a money judgment" (733 F.2d at 278)); see also *CFTC v. Co Petro Mktg.*, 700 F.2d 1279 (9th Cir. 1983) (CFTC action to enforce securities law by compelling law firm to return money received from a bankrupt company in violation of CFTC regulations does not qualify as an action to enforce a money judgment and is exempted from stay under Section 362(b)(5)).

⁷ Petitioner contends that application of the hot goods provision against a bankrupt debtor does not further the FLSA's goal of eliminating the competitive advantage enjoyed by hot goods, since the debtor's goods are "sold in a forced sale for a price which has no bearing on the cost of production" and the producer does not retain the profits from the sale (Pet. 12). This argument is unavailing. By concluding that the elimination of substandard goods from interstate commerce "is itself a central purpose of the FLSA" (*Citicorp*, slip op. 9 n.8), this Court has squarely rejected petitioner's position that the sale or transportation of these goods by the debtor or debtor's trustee is consistent with the Act's aims.

Moreover, as suggested in *Citicorp*, slip op. 10, enforcement of the hot goods provision notwithstanding bankruptcy will have the effect of discouraging persons able to monitor the operations of a financially troubled business—be they secured creditors or officers in the business—from financial practices that lead to minimum wage and overtime violations.

ring one set of creditors over others in violation of the Bankruptcy Code's priority of payments scheme. Until the taint is removed, creditors may not properly draw on the assets generated by the sale of those contraband goods. Just as in *Citicorp* the hot goods injunction did not give employees a "lien" on secured assets superior to that of a secured creditor (slip op. 11),⁸ so here, too, the injunction does not give employees any interest in property of the estate contrary to the normal rules of priority in bankruptcy. In both cases, the injunction allows the Secretary to keep tainted goods from entering the channels of interstate commerce, and the sale of the goods can only be legal under the statute if the minimum wages are paid to dissipate the taint.

Even if the hot goods are properly treated as part of the bankruptcy estate, the Bankruptcy Code contemplates that a trustee will pay the expenses of compliance with valid governmental regulations out of the bankruptcy estate. A trustee, who "must comply with the [state] environmental laws" (*Ohio v. Kovacs*, 469 U.S. 274, 285 (1985)), may charge compliance costs as an administrative expense having priority over creditors' claims under 11 U.S.C. 507(a)(1). See, e.g., *In re Wall Tube & Metal Products Co.*, 831 F.2d 118, 123 (6th Cir. 1987) (cost of hazard-

⁸ In *Citicorp*, slip op. 9-10, the Court noted that "[h]ad the Department of Labor not obtained an injunction in this case, petitioner, as a secured creditor, would have converted several weeks of labor by the debtor's employees into goods covered by its security interest." If the Secretary's action to eliminate the "taint" from the goods were barred in the instant case, the petitioner's creditors would similarly have converted several weeks of the debtor's employees' labor, and would thus have reaped the ill-gotten benefits of these goods' illegal sale. The ultimate result would be that "'hot goods' produced by these uncompensated employees would have competed with goods produced in conformity with the FLSA's minimum wage and overtime requirements" (*id.* at 10).

ous waste cleanup required by federal law may be “deemed an administrative expense” of the estate in bankruptcy). Similarly, a trustee choosing to sell goods produced in violation of the FLSA’s wage and hour requirements may charge the estate for removing the “taint” on these goods without violating the Bankruptcy Code’s priority payment scheme.

CONCLUSION

The petition for a writ of certiorari should be denied.
Respectfully submitted.

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SEPTEMBER 1988

APPENDIX

**UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF GEORGIA
STATESBORO DIVISION**

File No. CV 686-025

**WILLIAM E. BROCK, SECRETARY OF LABOR,
UNITED STATES DEPARTMENT OF LABOR, PLAINTIFF**

v.

RUSCO INDUSTRIES, INC., DEFENDANT

[Filed Mar. 20, 1986]

**ORDER GRANTING TEMPORARY RESTRAINING ORDER
AND PRELIMINARY INJUNCTION**

This matter is before the Court on plaintiff's Motion for Temporary Restraining Order and Preliminary Injunction. The essence of the motion, as well as the underlying Amended Complaint, which was filed under the Fair Labor Standards Act (29 U.S.C. section 201, *et seq.*), is that the defendant failed altogether to pay any wages to its employees employed at its facilities in Millen, Jenkins County, Georgia; Meadeville, Pennsylvania; and Santa Fe Springs, California for hours worked during the work-weeks ending January 24 and 31, 1986, in an amount of approximately \$150,000.00.

(1a)

Pursuant to section 15(a)(1) of the Act, it is unlawful for any person:

To transport, offer for transportation, ship, deliver, or sell in commerce, or to ship, deliver, or sell with knowledge that shipment or delivery or sale thereof in commerce is intended, any goods in the production of which any employee was employed in violation of section 6 [minimum wage] or section 7 [overtime]. . . .

The district court, sitting in equity, has the authority under section 17 of the Act to issue injunctions restraining violations of section 15 of the Act.

Here, plaintiff has requested a so-called "Hot Goods" injunction pursuant to section 15(a)(1), which would prohibit defendant from selling and/or shipping goods currently in inventory in interstate commerce unless or until the goods have been cleansed by payment of the back wages due its employees. As the court recently noted in *Ford v. Ely Group, Inc.*, 621 F.Supp. 22, 25-26 (W.D. Tenn. 1985; appeal pending, 6th Cir., No. 85-5249):

The basic purpose of the section 15(a)(1) prohibition, as the Supreme Court pointed out in *United States v. Darby*, 312 U.S. 100, 109-110, 61 S.Ct. 451, 454-55, 85 L.Ed. 609, "is to exclude from interstate commerce" goods produced under substandard labor conditions, which would compete unfairly with goods produced by complying employers, and which in their total effect might force complying employers out of business."

* * * * *

An action to enforce the section 15(a)(1) prohibition is brought, not to compel the foreclosing creditor to pay the statutory wages or to put pressure on the de-

faulting producer to pay such wages, but to keep tainted goods from entering the channels of interstate commerce in competition with goods produced under the Act's standards.

See also *Donovan v. TMC Industries*, 25 WH Cases 829 (N.D. Ga. 1982).

On February 26, 1986 and again on March 14, 1986, the Court held telephonic hearings with counsel for both parties and determined that in fact the employees had not been paid and that defendant had intentions of selling and/or shipping goods in inventory in interstate commerce.

It is the Court's opinion that under the undisputed facts of the case, allowing defendant to sell and/or ship goods in interstate commerce:

[W]ill result in the immediate and irreparable injury or damage to plaintiff and the public interest in that such shipment and movement of goods will make use of the channels and instrumentalities of interstate commerce to spread and perpetuate an unfair method of competition and interfere with the orderly and fair marketing of goods in commerce.

Ford v. Ely Group, Inc., *supra*, 621 F.Supp. at 26-27.

It is therefore ORDERED, ADJUDGED and DECREED that defendant, its officers, agents, servants, employees and all persons acting in concert and participation with them who receive notice hereof, hereby are temporarily enjoined and restrained from:

- (1) Paying their employees at rates less than the minimum wage rate prescribed by section 6 of the Act [29 U.S.C. 206]; and
- (2) transporting, offering for transportation, shipping, delivering or selling in commerce any goods

produced by their employees who were paid in violation of section 6 of the Act, or shipping, delivering or selling with knowledge that shipment or delivery or sale thereof in commerce of such goods or products is intended, in violation of section 15(a)(1) of the Act.

IT IS FURTHER ORDERED that defendant shall within five days of entry of this Order:

- (1) Make all of its time and payroll records for the period from the week ending January 24, 1986 to date available to plaintiff's representatives; and
- (2) submit to plaintiff's representatives an inventory of all goods stockpiled or stored at defendant's facilities in Millen, Jenkins County, Georgia, Meadville, Pennsylvania and Santa Fe Springs, California.

This Temporary Restraining Order shall remain in effect for 10 days from the date of entry and shall automatically be converted to a Preliminary Injunction upon expiration of the 10 days unless otherwise ordered by the Court.

Dated and ordered this 20th day of March, 1986.

/s/ DUDLEY H. BOWEN, JR.
Dudley H. Bowen, Jr.
United States District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF GEORGIA
STATESBORO DIVISION

Civil Action CV 686-025

WILLIAM E. BROCK, SECRETARY OF LABOR,
UNITED STATES DEPARTMENT OF LABOR, PLAINTIFF

v.

RUSCO INDUSTRIES, INC., DEFENDANT

[Filed Mar. 24, 1986]

ORDER

WHEREAS, this Court entered an order on March 20, 1986, restraining Rusco Industries, Inc. ("Rusco") from disposing of certain inventory through interstate commerce; and

WHEREAS, Rusco has filed a motion seeking to modify said order so that it may sell certain inventory and thereby generate proceeds for the benefit of its creditors; and

WHEREAS, Rusco states that the value of such inventory will decrease substantially unless it can be sold as soon as possible;

IT IS HEREBY ORDERED that Rusco is authorized to sell any inventory in its possession; provided, however, that the proceeds from such sales shall be made payable

to, and immediately forwarded to the Clerk, U.S. District Court, P. O. Box 1130, Augusta, GA 30903, attention case number CV686-025, for deposit to the registry of this Court pending further order thereon.

IT IS FURTHER ORDERED that the Bankruptcy Clerk of this district shall serve a copy of this order upon First National Bank of Atlanta, and AMR, Inc., the only known creditors claiming an interest in Rusco's inventory and accounts receivable, and upon the members of the equity security holders committee and unsecured creditor committee. Any parties in interest shall show cause before the undersigned district judge at a hearing to be held on April 21, 1986, at 5:00 o'clock P.M. at Savannah, Georgia, why such funds should not be applied to the unpaid wages of Rusco's employees which accrued prior to the [sic] Rusco's bankruptcy filing on February 3, 1986.

ORDER ENTERED at Augusta, Georgia, this 24th day of March, 1986.

/s/ DUDLEY H. BOWEN, JR.

United States District Judge

